

Key Market Highlights

- RBI kept the key policy rates i.e. Repo Rate, Reverse Repo Rate, and CRR Rate unchanged at 8.5%, 7.5% and 6.0% respectively in its mid-quarter policy on December 16, 2011.
- RBI acknowledged the growth momentum in the economy was moderating. While inflation remained high, RBI felt that in response to faltering growth it would have to reverse the rate hiking cycle going forward.
- Revised borrowing schedule for auction of government securities was announced on account of fiscal slippages. The revised schedule included additional borrowing of INR 40,000 crs for period January-March 2012
- The Index of Industrial Production (IIP) printed a really bad number of 5.1% contraction for the month of October 2011, which was the first negative reading since Jan 2009. Mining contracted by 7.2%, manufacturing fell 6%, while electricity grew by 5.6%. While the number looks really poor, officials have hinted at lesser number of working days in October because of Diwali holidays as the main reason for this contraction. Due to moderation in growth and tight monetary policy, the growth in IIP is expected to remain in single digit numbers for the next few months.
- Inflation as measured by Wholesale Price Index (WPI) for the month of November 2011 came as per expectations at 9.1% as compared to 9.7% in the previous month. Primary articles inflation fell to 8.5%, manufactured goods inflation was flattish at 7.7% while fuel inflation increased to 15.5% during the month. Non food manufacturing inflation, which is watched by RBI as a measure which indicates demand pressures in the economy increased to 8.0% compared to 7.6% in the previous month. However, due to high base effect, inflation is expected to fall to 6.5-7.0% by March 2012.
- Export growth dropped further from 10.8% for October 2011 to 3.9% for November 2011
- Import growth increased from 21.7% for October 2011 to 24.6% for November 2011
- Credit growth fell further from 17.7% in mid November 2011 to 17.1% in mid December 2011
- Deposit growth increased from 16.4% in mid November 2011 to 18.0% in mid December 2011

Source: www.rbi.org.in, Bloomberg

Market impact

Government securities market was positive during the month of December 2011.

Market sentiment was positive at the beginning of the month as RBI was conducting Open Market Operations (OMOs) every week to support liquidity in the system. IIP growth for October 2011 came at a shocking negative 5.1%, as against expectation of negative 0.7%. This triggered further buying interest in the market as everybody was hopeful that RBI would moderate its hawkish stance to support falling growth. Also, inflation for the month of November 2011 came at 9.10% which was as per market expectation. RBI in its mid-quarter policy did not hike any policy rates as per expectation. At the same time, RBI indicated that it would have to reverse the monetary tightening cycle going forward as inflation was falling as per projection, while growth was showing signs of moderation.

During the month, liquidity in the system continued to be very tight with RBI's average daily net lending to the system under Liquidity Adjustment Facility (LAF) window being around INR 116,000 crs. Due to this there was expectation that RBI would continue with OMOs to support liquidity. This, in addition to RBI's dovish statements caused yields to fall significantly and the yield on the 10 year benchmark bond dropped from 8.74% at the end of the previous month to a low of 8.28% during the month. However, there was some selling pressure seen before the year end as it was expected that the RBI would give a revised schedule of the borrowing programme during January-March 2012, which would be higher due to high fiscal deficit. As a result yield on the 10 year benchmark bond firmed up to 8.56% by end of the month.

Due to very tight liquidity situation, CD rates rose during the month. The 3 month CD rates increased from around 9.40-50% to around 9.80-90% level during the month and 1 year CD rates also increased from around 9.65-70% to 9.85-95% level during the month. However, by end of the month, three month CD rates fell to 9.30-40% level while 1 year CD rates fell to 9.60-70% due to improvement expected in liquidity in January 2012.

INR Swap curve also softened during the month due to RBI infusing liquidity in the system through OMOs. 1 year OIS softened from 8.04% by end of previous month to 7.75% by end of December 2011. The 5 year OIS rate also softened from 7.29% at the end of the previous month to 7.10% by the end of December 2011.

Our assessment

INR Yields were positive during the month on account of:

1. Due to very tight liquidity in the system, there was expectation the RBI would continue to conduct OMOs to support liquidity.
2. Also IIP number for October came at negative 5.1% which was sharply lower than expectation. Inflation came at 9.1% which was as per expectation. Due to this, there was expectation that RBI would not be hawkish in its mid-quarter policy review.
3. RBI in its mid quarter policy indicated that the monetary policy cycle could be reversed to supporting faltering growth. Due to this, yields softened significantly during the month.

Going Forward

1. Government securities market is expected to remain positive due to the expectation that RBI OMOs.
2. Inflation numbers are expected to moderate further due to high base effect. This is also positive for the markets.
3. The global weakness may continue or there could be shocks coming from the Euro zone due to sovereign debt problem. This could cause the yields to remain low.

Our portfolio strategy

Recap – December 2011

1. In the ING Income Fund and ING Gilt Fund – Provident Fund Dynamic Plan, we had high duration at beginning of the month. We further increased duration during the as RBI was more dovish than expectation in its mid-quarter policy review. However, by end of the month, we reduced duration significantly due to fears of higher borrowing being announced for January-March 2012.
2. In the ING Short Term Income Fund we continued with higher exposure to 3-6 months money market papers as the yields were attractive in that segment due to strained liquidity.
3. In ING Liquid Fund and ING Treasury Advantage Fund, we maintained judicious mix of cash and very short term instruments.

Strategy going forward

1. In the ING Income Fund and ING Gilt Fund – Provident Fund Dynamic Plan, we would look to actively manage duration to take advantage of any mispricing. We would continue to have high duration as the sentiment is positive due to continuing RBI OMOs. However, if rates fall excessively, we may reduce duration
2. In the ING Short Term Income Fund we would continue have around 25-30% exposure to 1-2 year papers as there is good carry in these assets. We would continue to have exposure to accrual assets, which are being traded at high rates. However, we would also look to increase duration opportunistically.
3. In ING Liquid Fund and ING Treasury Advantage Fund, we would continue to maintain a judicious mix of cash and very short term instruments. However, we would continue to give higher importance to ALM for these funds.

Gilt Outlook Matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Positive	<ul style="list-style-type: none"> ➤ Continuing OMOs being conducted by RBI to infuse liquidity in the system which helps in absorbing the excess supply. ➤ The global weakness may continue or there could be shocks coming from the Euro zone related to sovereign debt problem. 	<ul style="list-style-type: none"> ➤ Inflation continue to be at higher levels ➤ Successful and meaningful resolution of the Euro zone sovereign debt crisis could bring back risk appetite in the markets and yields could move higher
Long Term	➤ Positive	<ul style="list-style-type: none"> ➤ Expectation of RBI cutting rates in the longer horizon to support falling growth of the economy ➤ Moderation in inflation due to lower commodity prices and higher base effect coming into play ➤ Slow down in the developed economies as well as the domestic economy 	<ul style="list-style-type: none"> ➤ Inflation continues to remain at elevated levels ➤ Stronger than expected rebound in global or domestic growth ➤ Crude oil or commodity prices increase due to supply problems or stonger demand ➤ Higher than expected fiscal slippages in the next fiscal, which may translate into higher government borrowings

Corporate bond outlook matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Positive	<ul style="list-style-type: none"> ➤ Expectation of positive movement in the base G sec curve ➤ Improvement in liquidity due to RBI OMOs 	<ul style="list-style-type: none"> ➤ Any significant issue pertaining to credit quality of issuers
Long Term	➤ Positive	<ul style="list-style-type: none"> ➤ Expectation of positive movement in the base G-sec Curve ➤ Improvement in liquidity expected over longer horizon due to government expenditure and CRR cuts. 	<ul style="list-style-type: none"> ➤ Inflation continues to remain high ➤ Stronger than expected global / domestic growth numbers ➤ Higher supply of G sec could lead to crowding out effect for corporate bonds

Month end levels

Sovereign: The 10 year benchmark bond i.e. 8.79% Govt bond maturing in 2021 closed at 8.56% by end of December 2011 compared 8.74% at the end of the previous month

Credits: 3 month CD rates increased from around 9.40-50% to around 9.80-90% level during the month and 1 year CD rates also increased from around 9.65-70% to 9.85-95% level during the month. However, by end of the month, three month CD rates fell to 9.30-40% level while 1 year CD rates fell to 9.60-70% due to improvement expected in liquidity in January 2012. During the month, the yield on a 10 yr AAA corporate bond also fell from 9.70 % at the end of November 2011 to 9.42% by end of December 2011.

OIS: INR Swap curve also softened during the month due to RBI infusing liquidity in the system through OMOs. 1 year OIS softened from 8.04% by end of previous month to 7.75% by end of December 2011. The 5 year OIS rate also softened from 7.29% at the end of the previous month to 7.10% by the end of December 2011.

Source for all data in this document is www.rbi.org.in and/or Bloomberg.



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Nature & Investment Objective: ING Income Fund: An open ended income scheme which seeks to generate attractive income by investing in a diversified portfolio of debt and money market instruments of varying maturities, and at the same time provide continuous liquidity along with adequate safety. **ING Gilt Fund Provident Fund Dynamic Plan:** An open ended gilt scheme which seeks to generate relatively risk free return by investing in sovereign instruments issued by the central/state government as defined under section 2 of Public Debt Act, 1944. The scheme will not make investments in any other type of security such as shares, debentures etc. **ING Short Term Income Fund:** An open ended income scheme which seeks to generate an attractive return for its investors consistent with capital preservation and liquidity by investing in portfolio of quality debt securities, money market instruments and structured obligation. **ING Treasury Advantage Fund:** An open ended income scheme which seeks to provide an investment avenue for investors preferring good liquidity and an investment horizon of 2 – 6 months. The scheme would be able to achieve its objectives by investing in a portfolio of money market and debt instruments. **ING Liquid Fund:** An open ended liquid scheme which seeks to provide reasonable returns while providing a high level of liquidity and low risk by investing primarily in money market securities. The aim is to optimize returns while providing liquidity. **Statutory Details: Sponsor:** ING Group, through its wholly owned subsidiary, Nationale Nederlanden Interfinance B.V., **Trustee:** Board of Trustees of ING Mutual Fund, **Investment Manager:** ING Investment Management (India) Private Limited.

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